

DOCKET SECTION

BEFORE THE  
POSTAL RATE COMMISSION

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POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

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**ANSWERS OF UNITED PARCEL SERVICE WITNESS  
J. STEPHEN HENDERSON TO INTERROGATORIES OF  
THE PARCEL SHIPPERS ASSOCIATION  
(PSA/UPS-T3-1 through 9)**

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(February 11, 1998)

Pursuant to the Commission's Rules of Practice, United Parcel Service ("UPS") hereby serves and files the responses of UPS witness J. Stephen Henderson to interrogatories PSA/UPS-T3-1 through 9 of the Parcel Shippers Association.

Respectfully submitted,

  
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**ANSWER OF UNITED PARCEL SERVICE WITNESS  
J. STEPHEN HENDERSON TO INTERROGATORY  
OF THE PARCEL SHIPPERS ASSOCIATION**

**PSA/UPS-T3-1.** With reference to your comparison on page 19 of the Postal Service's proposed rates and your recommendations, where you state that the Postal Service has proposed 103.9% cost coverage and your rates would produce 107.1% cost coverage, please confirm the following:

(a) Because the Postal Service's total attributed costs are 56% of total costs and yours are 63.9% of total postal costs, the pool of institutional cost to be recovered through cost coverages is substantially smaller under your proposal.

(b) Average coverage under the Postal Service's proposed attribution of costs equals 178.5%, and average coverage under your proposed attribution of costs is 156.4%.

(c) Since Parcel Post coverage proposed by the Postal Service assumes attributable costs are 56% of total costs, then to have the same equivalent coverage as proposed by USPS under your proposed 63.9% attribution of total costs the coverage for parcel post would have to be 102.87%

(d) Since, at 63.9% attribution of costs, parcel post coverage equivalent to the USPS' proposed coverage would be 102.76%, then your proposed coverage of 107.1% would require parcel post to contribute in percentage terms almost 2-1/2 times as much toward payment of the nonattributed cost pool as under the Postal Service's proposal.

**Response to PSA/UPS-T3-1.** (a) Confirmed.

(b) Taking into account rounding error in your calculations, confirmed. As shown in UPS-Henderson-WP-I, Tables 1 and 2, average cost coverage is 178.4 percent under the Postal Service's proposal and 156.3 percent under my recommended approach.

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(c) Not confirmed. Your concept of equivalent coverage is not clear. In any case, aggregate coverage ratios cannot be applied to an individual subclass, such as Parcel Post, as you suggest.

(d) Not confirmed. See my answer to (c).

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**PSA/UPS-T3-2.** You state that you began marking up parcel post by starting with the most recently pronounced appropriate cost coverage as found by the Postal Rate Commission, and that was 107% for parcel post in Docket No. R94-1 (p. 19). In order to maintain this 107% cost coverage, you found it necessary to propose overall rate increases for parcel post of 28% (p. 22), whereas the overall average increase required to cover the anticipated cost increases projected into the Test Year experienced by the Postal Service since the last rate case is around 4%. Please provide an explanation of what has happened to parcel post costs, as determined by the Rate Commission in the last case, that has caused the Postal Service to experience such a gigantic increase in the cost of handling parcel post, whereas the other cost increases in handling other classes of mail are such that they do not on average require more than a 4% increase.

**Response to PSA/UPS-T3-2.** As I state on page 22, line 17, ". . . attributable costs per piece in the test year will be 7.2 percent higher than the attributable costs estimated by the Commission in Docket No. R94-1." I do not consider a 7.2 percent increase to be "a gigantic increase in the cost of handling parcel post."

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**PSA/UPS-T3-3.** On page 5 of your testimony, where you discuss the Postal Reorganization Act Rate Criterion of "available alternatives," you talk about certain services where "mailers have readily available alternatives." Do you believe that mailers have "readily available alternatives" for the ground transportation of parcels to residences, and, if the answer is in the affirmative, please identify each and every "readily available alternative" for a mailer who has a need to distribute parcels to residences on a national bases.

**Response to PSA/UPS-T3-3.** Yes. The Postal Service and UPS provide ground based delivery of parcels to residences nationwide. FedEx, Airborne, and Emery provide air based delivery of parcels. FedEx had begun to enter the ground market and has recently purchased Caliber (RPS). A multitude of smaller, regional and local firms provide ground, air, or mixed delivery services. These firms provide readily available alternatives for ground transportation of parcels to residences in competition to the integrated nationwide enterprises. It is not necessary that home delivery be provided by a vertically integrated firm for competition to be effective. Contractual arrangements among firms providing various transportation segments can substitute effectively for integrated service. Please see the testimony of Mr. Clark for CTC Distribution Services and that of the witnesses for the Association of Alternative Postal Systems.

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**PSA/UPS-T3-4.** At page 5 of your testimony you discuss the “effect of rate increases” criterion and state that “any rates that would unfairly disadvantage competitors may be set higher.” Is it your position that the parcel post rates proposed by the Postal Service in this proceeding would have an injurious impact upon United Parcel Service in its provision of ground parcel transportation? If the answer is in the affirmative, please supply all necessary data to document your response, not limited to, but including,

(a) detailed information on United Parcel Service’s ground transportation volumes;

(b) a comparison of damaging parcel rates and actual rates charged to UPS customers for the provision of such services;

(c) a comparison of the actual negotiated contract rates that UPS may have with its major customers with rates proposed by the Postal Service in this proceeding;

(d) a description of the amount of parcel post volume United Parcel Service believes was diverted away from it to the Postal Service because of parcel post rates;

(e) an estimation of the amount of parcels United Parcel Service anticipates it will lose to parcel post if the proposed rates are adopted in this proceeding.

If the witness is unable to respond to all or any part of this question, please refer such parts to the appropriate official at United Parcel Service who would be competent to respond.

**Response to PSA/UPS-T3-4.** I have not investigated the impact that the Parcel Post rates proposed by the Postal Service would have on UPS. My testimony is that unfair Parcel Post rates could injure competitors such as UPS.

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**PSA/UPS-T3-5.** (a) Is it not the case that UPS' parcel post volume has increased far in excess of the increases in parcel post volume since Docket No. R94-1, despite yearly rate increases by UPS, and that, therefore, the Postal Service has not been able to secure its proper share of the increased parcel post market, the lion's share of which has gone to UPS? If the answer is other than affirmative, please supply data to document your response.

(b) If it is the case that the Postal Service has failed to obtain its share of the increased parcel post market, and therefore has less "value of service," one of the criteria to which you advert on page 4 of your testimony, does this not compel a conclusion that parcel post coverage should be the lowest possible in order to enhance its competitive opportunities in the market?

**Response to PSA/UPS-T3-5.** (a) There is no "proper share of the increased parcel post market" that any particular enterprise deserves. I have not computed market shares as a part of my testimony, and so I cannot confirm the facts on which your question is based.

(b) Not applicable.

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**PSA/UPS-T3-6.** You have recommended, as a model for mark ups, use of the mark ups reflecting the Commission's judgment in the most recent rate case Docket No. R94-1. You state that you have therefore used the Commission's relative mark ups in that case to determine the appropriate contribution in this case to recover institutional costs. Is it not the case that, if the percentage of attributable costs determined in Docket No. R94-1 is less than the percentage of attributable costs that you propose, then a strict application as you propose of the Docket R94-1 cost coverages would produce revenue in excess of that required?

**Response to PSA/UPS-T3-6.** No. I have scaled the Commission's Docket No. R94-1 markups as described in the Appendix to my testimony, page 9, lines 8-19, to ensure that the model meets the break-even requirement.



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**PSA/UPS-T3-7.** On page 22 of your testimony you state that the average rate for parcel post is already substantially below cost, citing USPS-T-37, at page 24, and stating that a 19.4% increase is needed simply to cover the cost shortfall and reach the Docket No. R94-1 cost coverage of 107%. Please confirm that the average rate for parcel post is, as you say, substantially below cost only because the Postal Service testimony that you cite deviates from established Commission policy and attributes 100% of Alaska air costs to parcel post.

**Response to PSA/UPS-T3-7.** Not confirmed. While it is true that my rate increase recommendation is based on the attribution of 100 percent of Alaska Air costs to Parcel Post, this is not the only reason why current Parcel Post rates fail to cover costs. The attached exhibit shows the impact of attributing only 20.54 percent of Alaska Air costs to Parcel Post as the Commission recommended in Docket No. R94-1. The attachment shows that removing \$77 million of Alaska Air costs from Parcel Post results in attributed cost per piece of \$3.31. Consequently, Parcel Post's current average rate of \$3.05 (TYBR, O'Hara W/P I, page 3 of 3) is 8.5 percent below costs even if Alaska Air costs are treated as the Commission did in Docket No. R94-1. In this instance, the Parcel Post average rate needed to achieve a cost coverage of 107 percent would be \$3.55, which would constitute a 16.4 percent increase, as opposed to my recommended increase of 27.6 percent.

	PRC 1994 Cost	New 1994 Cost	PRC 1994 Cost	New 1994 Cost	Volume Variable Per Piece (\$)	Fixed Cost Per Piece (\$)	Incremental Cost Per Piece (\$)	Price (\$)	Volume (Millions)	Price Cost (\$)	Price Error (\$)	Price Error <sup>2</sup> (\$ <sup>2</sup> )	Revenue (\$ Millions)	Volume Variable Cost (\$ Millions)	Incremental Cost (\$ Millions)	Net Incremental Cost (\$ Millions)	Price Increase from 1994 (%)	Cost Coverage
[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]	[12]	[13]	[14]	[15]	[16]	[17]	[18]	
First Class Mail Total Letters	1,745	1,717	0,745	0,717	0,183	0,000	0,202	0,348	95,823	0,348	9E-10	7E-19	33,201	16,529	19,398	19,398	2.0	1,717
Express Mail	1,367	1,353	0,367	0,353	0,116	0,000	0,120	0,162	6,544	0,162	5E-10	2E-19	1,080	762	783	783	-13.0	1,353
Priority Mail	1,972	1,935	0,972	0,935	2,281	0,119	2,417	4,677	977	4,677	-7E-09	2E-18	4,572	2,310	2,363	2,363	22.1	1,935
Mailgrams **	1,189	1,182	0,189	0,182	7,823	2,787	11,445	13,526	62	13,526	-4E-10	2E-19	837	484	709	536	4.5	1,182
Periodicals	1,016		0,016		0,113	0,000	0,112	0,903	5				5	1	1	1	0.0	8,811
In Country Nonprofit Classroom Regular Rate	1,027 1,041 1,068 1,163	1,026 1,009 1,059 1,157	0,027 0,041 0,068 0,163	0,026 0,039 0,065 0,157	0,096 0,166 0,313 0,244	0,000 0,000 0,000 0,000	0,098 0,168 0,314 0,246	0,100 0,175 0,335 0,285	865 2,113 29 6,959	0,100 0,175 0,335 0,285	-3E-10 5E-10 8E-10 6E-10	7E-20 2E-19 8E-19 3E-19	87 370 10 1,982	83 331 9 1,698	85 356 9 1,714	85 356 9 1,714	10.6 14.2 62.1 26.2	1,026 1,039 1,065 1,157
Standard Mail A																		
Commercial Regular	1,320	1,306	0,320	0,306	0,154	0,000	0,155	0,203	38,322	0,203	-5E-10	3E-19	7,786	5,886	5,854	5,953	-2.9	1,306
Commercial ECR	2,060	2,019	1,060	1,019	0,069	0,000	0,072	0,146	29,176	0,146	1E-09	1E-16	4,255	2,022	2,107	2,106	0.1	2,019
Nonprofit	1,050	1,046	0,050	0,046	0,115	0,000	0,117	10,620	210	1,590	4E-10	1E-19	1,297	1,224	1,228	1,228	6.1	1,046
Nonprofit ECR	1,416	1,400	0,416	0,400	0,052	0,000	0,053	0,074	2,593	0,074	6E-10	4E-19	191	136	136	136	-12.0	1,400
Standard Mail B																		
Parcel Post	1,074	1,071	0,074	0,071	3,305	0,000	3,313	3,549	221	3,549	-2E-10	3E-20	765	731	732	732	16.2	1,071
Bound Printed Matter	1,365	1,352	0,365	0,352	0,676	0,000	0,677	0,915	574	0,915	-5E-11	3E-21	526	386	389	389	5.4	1,352
Special Rate	1,046	1,044	0,046	0,044	1,484	0,000	1,484	1,580	210	1,590	4E-10	1E-19	325	311	311	311	-12.2	1,044
Library Rate	1,008	1,008	0,008	0,008	2,008	0,000	2,008	2,024	27	2,024	4E-08	1E-15	54	54	54	54	26.8	1,008
Free-for-the-Bird, etc. ***	0,000				0,670	0,000	0,671	0,000	56				0	36	36	36		0,000
International Mail **	1,218		0,218		1,283	0,016	1,300	1,633	1,007	1,644			1,644	1,291	1,309	1,293	3.0	1,256
Special Services **																		
Registry	1,445		0,445		7,186	0,000	7,046	8,561	14				123	103	101	101		
Certified	1,702		0,702		1,201	0,												

TOTAL

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**PSA/UPS-T3-8.** On page 23 of your testimony you state that the parcel post mark up, under economically efficient pricing, should require that parcel post rates exceed attributable costs each and every year, not just in the Test Year, and that with a low mark up proposed by the Postal Service rates will likely be below attributable costs for much of the time that they are in effect. Please confirm that, utilizing PRC-approved methodology for the handling of Alaska air costs, parcel post has fully recovered its attributable costs each and every year for which there is data since Docket No. R94-1.

**Response to PSA/UPS-T3-8.** I have not collected the data needed to answer this question as part of the work supporting my testimony.

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J. STEPHEN HENDERSON TO INTERROGATORY  
OF THE PARCEL SHIPPERS ASSOCIATION**

**PSA/UPS-T3-9.** You state that your proposed overall rate increase for parcel post of 28% ". . . is not excessive given that it is based on increases in its cost." Would you agree that a 28% increase for parcel post would be excessive if it should be that the Commission determines that a 28% increase is not necessary in order to meet 107% coverage of the costs that the Rate Commission, utilizing its methodologies, determines to be properly attributed to parcel post?

**Response to PSA/UPS-T3-9.** Under your hypothetical question, the Commission is assumed to have determined attributed costs at some unspecified level and adopted its Docket No. R94-1 markup of 7 percent with the result that the rate increase needed to achieve 107 percent cost coverage is smaller than 28 percent. In such circumstances, the rate is cost justified and the rate increase is whatever it is. The 28 percent figure would no longer be relevant. I cannot say whether a 28 percent rate increase would be "excessive" under those circumstances without knowing the rate increase needed to achieve a cost coverage of 107 percent.

## DECLARATION


I, J. Stephen Henderson, hereby declare under penalty of perjury that the foregoing answers are true and correct to the best of my knowledge, information, and belief.

  
\_\_\_\_\_  
J. Stephen Henderson

**Dated:** February 10, 1998

**CERTIFICATE OF SERVICE**

I hereby certify that I have this date served the foregoing document in accordance with section 12 of the Commission's Rules of Practice.

  
John E. McKeever

Dated: February 11, 1998  
Philadelphia, PA